# Executive Summary

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**"Exchange Rates, Expansion of Foreign Direct Investment and Regional Trade"**

1. The currency fluctuation of Asian currencies relative to the U.S. dollar during the eleven year period from 1985 to 1995 can be summarized by the following three major trends against the background of the strong yen and weak dollar that was precipitated by the Plaza Accord of September, 1985:
   1) steady appreciation;
   2) fluctuation within a narrow range; and
   3) steady depreciation.

   Responding to yen-dollar exchange fluctuation, Asian currencies have depreciated considerably against the Japanese yen after having gone through a period of great volatility.

2. As an index of the international competitiveness of Asian economies, both real and nominal effective exchange rates have been calculated. The result indicates that the effective exchange rates are lower than the nominal effective exchange rates for Singapore, Taiwan and Malaysia. This is an indication of the fact that these three countries have been successful in containing inflation and avoiding currency depreciation against other currencies.

3. Since 1985, Asian NIEs and the ASEAN countries have seen an increase in direct investment activities by industrialized nations including the U.S. and Japan in response to both the strong yen and the liberalization of trade and investment policies in the region. Furthermore, in response to the appreciation of their currencies against the U.S. dollar and rising domestic labor costs from 1987 to 1990, Asian NIEs have invested heavily in the ASEAN countries. Investment by industrialized countries and Asian NIEs into China saw a sharp rise since 1992, when the country began instituting its open-economy policies on a full scale.

   Direct investment as a form of leverage, changes in the industrial structure of Asian NIEs and industrialization and the upgrading of industrial structure among the ASEAN countries have accelerated while China's industrialization has been promoted. As a result of these new developments, a new intra-regional production network involving the U.S. and Japan has emerged. This network is based on an intra-regional division of labor in terms of processes entailing not only traditional light industrial goods but also machinery. Consequently, intra-regional trading activities have intensified and expanded.

**"The Issue is on the Supply Side"**

4. Viewing this process in terms of managing the demand side of each economy, this growth pattern was made possible by growth in exports

and growth in total fixed capital formation (i.e., private sector investment in plant and equipment plus public sector investment).
In order for the Asian economies to sustain current growth patterns, a number of supply-side issues, such as the enhancement of human resources, development of supporting industries, technological and infrastructure improvements, as well as the containment of inflation, must be addressed.
Moreover, in spite of increased export activities, ASEAN countries are showing deficits in their current account balances due to an increase in the import of raw and intermediate materials and capitals goods resulting from intensified production and investment activities.

5. By encouraging domestic saving, Asian countries have been promoting the growth of their own capital and financial markets so as to attract foreign investment. In recent years, capital inflow in the form of portfolio investment and short-term fund from the U.S. and Japan have made significant contributions to the formation of such markets. However, they have also resulted in inflationary pressures on the domestic economies.

### "U.S. Dollar Shows a High Share"

6. In the areas of merchandise trade, capital transactions and foreign reserves management, the U.S. dollar takes up a large share of the totals. The Asian economies continue to carry out foreign exchange policies designed to sustain the stability of their currencies vis-a-vis the U.S. dollar. There are not any major problems associated with these policies for the following reasons. First, the income generated through exports to the U.S. is stable. More importantly, the so called global money that has been flowing into the Asian countries from the U.S. has been in the form of highly marketable capital such as securities and short-term fund instruments.

7. No progress has been seen in the use of the Japanese yen as an international currency (i.e., the expanded use and holding of yen) in Asia. In the field of trade, the shares of yen based settlements among Japanese firms trading with Southeast Asian countries have declined since the beginning of 1993 due to yen appreciation. One contributing factor to this phenomenon is that in the face of intensified competition in Southeast Asian markets it has become increasingly difficult for Japanese corporations to shift the risks associated with exchange rate fluctuation to their trading partners.
In recent years, the Japanese firms operating in Asia have begun to reorganize their respective intra-regional corporate structures by reducing the degree of dependency on Japan and increasing local procurement of raw materials and parts. This type of corporate behavior has resulted in the reduction of the use of yen as a settlement currency for regional trading activities and thus contributes to the expanded use of the U.S. dollar or selected Asian currencies as settlement currencies.

8. When countries such as those ASEAN countries experiencing deteriorat-

ing balance of current account become more dependent on short-term capital for financing their deficits, their currencies may become less stable.

In other words, the necessity to form an international cooperative scheme designed to avoid the type currency crisis that occurred in Mexico has heightened. In addressing this issue, beginning last fall central banks from ASEAN countries began to form alliances by entering into agreements to share intervention funds and short-term mutual accommodation schemes. In this regard, Japan needs to aggressively engage itself in the formulation of international cooperative mechanisms by maintaining close communications with other Asian countries.

At the APEC Finance Ministers' Conference held on March 16 and 17, 1996, in Kyoto, an agreement was reached stating that "APEC welcomes the progress in the strengthening of the cooperative relationship among the financial authorities of the APEC countries."

## "Growth Strategies in the Age of Global Money"

9. Speaking of the management of economic policies in Asian countries especially in ASEAN member countries, mid to long-term growth strategies should be accurately assessed and carried out with concern to financial and foreign exchange policy restrictions inherent in the age of global money. Such strategies should eliminate macro-economic imbalances as well as bottlenecks for growth in production and capital procurement capabilities. Taking such long-term policies into account, it is necessary to enforce a comprehensive measure which would incorporate necessary adjustment policies containing price increases and reduction of short-term current account deficits.

   In viewing Asia's future foreign exchange policies, it appears that the majority of such policies will basically be for adjusting to exchange rate fluctuation vis-a-vis the U.S. dollar. However, it is also likely that such policies will be used as adjustment tools relative to the Japanese yen. It will be difficult for Asian countries to increase the international competitiveness of their economies by employing foreign exchange rate policies. Such policies may be used as tools for avoiding inflation induced by economic growth. Therefore, the manner in which these two seemingly dissimilar characteristics in foreign exchange policy are addressed will be critical in carrying out successful policy.

10. Asian countries expect the Japanese government to implement policies to contain the exchange rate fluctuation of the Japanese yen relative to the U.S. dollar to within the 100 yen range, and minimize the scope of the yen's fluctuation vis-a-vis the U.S. dollar. They would also like Japan to increase its imports from Asian countries and to step up the level of portfolio and direct investment in Asia.

    Some countries have also expressed the opinion that Japan should put more effort into the training of their work force in the foreign exchange and financial sectors in addition to the training of ordinary workers.

## Framework of Growth Strategy in the Age of Global Money